



SMALL BANK

Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

PUBLIC DISCLOSURE

May 12, 2004

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**The First National Bank of Menahga
Charter Number 11740**

**21 Main St. NE
Menahga, MN 56464**

**Comptroller of the Currency
North Dakota & NW Minnesota
1309 Highway 29 North, P. O. Box 849
Alexandria, MN 56308**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

Institutions CRA Rating: This institution is rated Outstanding.

An institution in this group has an outstanding record of helping to meet the credit needs of the assessment area in a manner that is consistent with its resources and capabilities.

- The First National Bank of Menahga's lending in the Assessment Area (AA) meets the standard for outstanding performance. A significant majority of the bank's loans are made within the AA.
- The bank's record of residential real estate and consumer lending exceeds the standards for satisfactory performance.
- The bank's geographic distribution of loans throughout the AA exceeds the standards for satisfactory performance.

Description of Institution

The First National Bank of Menahga (FNB) is a \$49 million financial institution with its main office location in Menahga, Minnesota, which is located in Wadena County in north central Minnesota. The bank has no branch offices and operates no depository automatic teller machines. FNB is owned by Menahga Bancshares, Inc., a one-bank holding company located in Menahga, Minnesota. There have been no acquisitions or mergers since the previous CRA examination.

The bank's loan portfolio is diverse. As of March 31, 2004, the composition of the loan portfolio is as follows:

Loan Portfolio Composition	\$ (000)	%
Commercial Loans (including real estate)	10,114	36.9%
Residential Real Estate	8,772	32.0%
Agriculture Loans (including real estate)	5,345	19.5%
Consumer Loans	3,070	11.2%
Other Loans	110	.4%
Total	27,411	100.0%

FNB offers a wide variety of financial products and services and its lending focus is on residential real estate, business and consumer loans. Net loans represent 55% of total assets. The bank's Tier 1 Leverage Capital is 11.08% of average assets, or \$5.4 million. There are no legal or financial impediments that would restrict the bank's ability to meet the credit needs of the community.

FNB was rated "Satisfactory" at the last CRA examination dated November 2, 1998.

Description of First National Bank of Menahga's Assessment Area

FNB's assessment area (AA) includes eight contiguous census tracts (CT) located in Becker, Hubbard, Otter Tail and Wadena counties of Minnesota. Based on the 2000 census information, the AA includes two moderate-income and six middle-income CT. There are no low-income or upper-income tracts in the AA. This is a change from the 1990 census when these eight CT included five moderate-income and three middle-income CT.

The AA meets the requirements of the regulation, and does not exclude any low- or moderate-income geographies. Cities in the AA include, but are not limited to Menahga, Park Rapids and Sebeka. Based on the 2000 census, the community of Menahga has a population of 1,220. The community of Park Rapids is the largest city in the AA with a population of 3,276.

There are six financial institutions with offices in or adjacent to the AA. In addition, there is a credit union and several mortgage companies. The bank identifies the two commercial banks and a thrift institution in Park Rapids as its primary competition. As of March 31, 2004, these financial institutions are Citizens National Bank with total assets of \$162 million, Northwoods Bank of Minnesota with total assets of \$89 million and State Bank of Park Rapids with total assets of \$87 million.

The local economy is reliant on small businesses, logging/lumber operations and agriculture. The major employers, outside of small farms and small businesses, include a nursing care facility and the Menahga Public School system.

Information from the Bureau of Labor Statistics lists the 2003 unemployment rates for Becker, Hubbard, Otter Tail and Wadena counties as 5.6%, 5.5%, 5.0%, and 5.4% respectively. The average unemployment rate for Minnesota 4.3% and is 5.5% nationwide.

During our evaluation, we contacted a member of the Menahga Development Corporation to better understand the credit needs of the AA. Based on this information we found that that FNB effectively meets the community's needs. Primary credits needs identified were business and residential real estate loans.

The demographics of the AA are illustrated in the table below. The information is based on 2000 census data unless otherwise indicated.

DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS OF AA	
<i>Population</i>	
Number of Families	7,243
Number of Households	10,136
Number of Low-Income Families	1,697
% of Low-Income Families	23%
Number of Moderate-Income Families	1,646
% of Moderate-Income Families	23%
Number of Middle-Income Families	1,871
% of Middle-Income Families	26%
Number of Upper-Income Families	2,029
% of Upper-Income Families	28%
<i>Geographies</i>	
Number of Census Tracts/BNA	8
% Low-Income Census Tracts/BNA	0%
% Moderate-Income Census Tracts/BNA	25%
% Middle-Income Census Tracts/BNA	75%
% Upper-Income Census Tracts/BNA	0%
<i>Median Family Income (MFI)</i>	
1990 MFI for AA	\$22,642
2000 MFI for AA	\$39,291
2003 HUD-Adjusted MFI	\$51,700
<i>Economic Indicators</i>	
Unemployment Rate	3%
2000 Median Housing Value	\$87,118
% of Households Below Poverty Level	11%

Loan Sampling

The bank's primary loan types were determined by reviewing all loans originated in 2002 through April 30, 2004 with an outstanding balance.

Loan Products	#	%	\$ (000)	%
Agricultural Loans	175	13%	3,898	18%
Business Loans	286	22%	7,902	37%
Consumer Loans	654	50%	3,665	17%
Real Estate Loans	43	3%	1,055	5%
Residential Real Estate Loans	136	10%	4,291	20%
Other	20	2%	552	3%
Total	1,314	100%	21,363	100%

Loans originated during the evaluation period: January 1, 2002 to April 30, 2004.

For the purpose of this evaluation, the primary loan types are residential real estate loans, business loans and consumer loans. Business loans account for 37% of the volume and residential real estate loans represent 20% of the volume of all originations with an outstanding balance. In addition, consumer loans account for 50% of the number of loans originated with an

outstanding balance.

To conduct our analysis, we performed statistically valid sampling techniques selecting a sample of 41 residential real estate loans, 42 business loans and 45 consumer loans. After initial sampling to determine the bank's lending within the AA, additional files were selected so that all loans in the sample were made within the AA. This resulted in a final sample of 40 residential real estate loans, 40 business loans and 40 consumer loans.

Conclusions about Performance Criteria

Loan-to-Deposit Ratio

FNB's loan-to-deposit ratio (LTD) meets the standards for satisfactory performance given the size, financial condition, assessment area needs, and local economic conditions. Since the last CRA evaluation, the bank's average quarterly LTD ratio is 63%.

A comparison to four similarly situated banks shows FNB is ranked third out of four banks. These banks are all under \$50 million and located in Becker, Hubbard, Otter Tail and Wadena counties. The quarterly LTD ratios for these banks are similar and range from 55% to 65%. The following table illustrates the total assets and LTD ratios for these banks.

Institution	Assets (as of 12/31/03)	Average LTD Ratio (9/30/03 – 12/31/03)
Farmers and Merchants Bank of New York Mills	48,439	66%
Security State Bank of Sebeka	25,376	65%
The First National Bank of Menahga	49,130	63%
Vergas State Bank	35,609	55%

Lending in Assessment Area

Lending within the AA exceeds the standard for satisfactory performance. A substantial majority of the loans are originated within the AA with 94% of the number of loans and 99% of the dollar of all sampled loans originating in the AA. We used our sample of residential real estate loans, business loans and consumer loans. The following table illustrates lending activity within the AA during the evaluation period.

Lending in Assessment Area										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
1-4 Family	40	98%	1	2%	41	2,226	98%	36	2%	2,262
Commercial loans	40	95%	2	5%	42	1,771	99%	11	1%	1,782
Vehicle loans	40	89%	5	11%	45	315	93%	23	7%	338
Totals	120	94%	8	6%	128	4,312	99%	52	1%	4,364

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

Overall, lending to borrowers of different incomes and to businesses of different sizes exceeds the standard for satisfactory performance. Lending to residential real estate and consumer loans exceeds the standard for satisfactory performance while lending to businesses of different sizes meets the standard for satisfactory performance.

Residential Real Estate Loans

The borrower distribution of residential real estate loans exceeds the demographics of the AA. The following chart illustrates that 25% of the number of loans sampled are to low-income families and 35% of the number of loans sampled are to moderate-income families. The demographic information indicates that 23% of the families in the AA are low-income and 23% are moderate-income.

Borrower Distribution of Residential Real Estate Loans								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
1-4 Family loan sample	23%	25%	23%	35%	26%	20%	28%	20%

Business Loans

Lending to small businesses meets the demographics of the AA. Of the loans included in our sample, 78% of the number and 46% of the dollar volume are to businesses with revenues under \$1 million. The demographic information indicates that 75% of the businesses in the AA have revenues in this category. Refer to the following table.

Borrower Distribution of Loans to Businesses				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses*	75%	4%	21%	100%
% of Bank Loans in AA by #	78%	12%	10%	100%
% of Bank Loans in AA by \$	47%	49%	4%	100%

*Comparable data for 2002 and 2003.

Consumer Loans

The borrower distribution of consumer loans to low- and moderate-income households exceeds the demographics of the AA.

The following chart illustrates that 60% of the number of loans sampled are to low-income households and 23% of the number of loans sampled are to moderate-income households. The demographic information indicates that 26% of the households are low-income and 19% of the households are moderate-income.

Borrower Distribution of Consumer Loans								
Borrower Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
Consumer Loan Sample	26%	60%	19%	23%	22%	15%	33%	2%

Geographic Distribution of Loans

FNB's geographic distribution of loans throughout the AA exceeds the standards for satisfactory performance. Lending in all categories, residential real estate, business and consumer loans exceeds the standard for satisfactory performance.

Residential Real Estate

Residential real estate loans made to individuals living in the moderate-income CT exceeds the demographics for the distribution of the AA.

As illustrated in the table below, 85% of the number of loans originated in 2002 were made in CT with moderate-income owner occupied housing compared to 66% of the moderate-income owner occupied housing in the AA. The table also shows that 50% of the 2003 and YTD 2004 loans sampled were made in CT with moderate-income owner occupied housing compared to 22% of the of the moderate-income owner occupied housing in the AA.

Geographic Distribution of Residential Real Estate Loans								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
2002 loan sample*	N/A	N/A	66%	85%	34%	15%	N/A	N/A
2003 and YTD 2004 loan sample**	N/A	N/A	22%	50%	78%	50%	N/A	N/A

* Information compared to 1990 census data.

** Information compared to 2000 census data.

Business Loans

Lending to small businesses located in the moderate-income CT exceeds the demographics of the AA. As illustrated in the following table, 90% of the number of loans originated in 2002 were made to businesses in moderate income CT compared to 87% of the AA businesses located in moderate income CT. The table also shows that 55% of the 2003 and YTD 2004 loans sampled were made in CT with moderate income compared to 36% of the AA businesses located in moderate-income CT.

Geographic Distribution of Loans to Businesses								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
2002 loan sample*	N/A	N/A	87%	90%	13%	10%	N/A	N/A
2003 and YTD 2004 loan sample**	N/A	N/A	36%	55%	64%	45%	N/A	N/A

* Information compared to 1990 census data.

** Information compared to 2000 census data.

Consumer Loans

Consumer loans made to individuals living in the moderate-income CT exceeds the demographics for the distribution of the AA.

As illustrated in the following table, 90% of the number of loans originated in 2002 were made to moderate-income households compared to 70% of the families in the AA that are located in a moderate-income CT. The table also shows that 55% of the 2003 and YTD 2004 loans sampled were made to moderate-income families compared to 27% of the families in the AA.

Geographic Distribution of Consumer Loans								
Census Tract Income Level	Low		Moderate		Middle		Upper	
	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans	% of AA Households	% of Number of Loans
2002*	N/A	N/A	70%	90%	30%	10%	N/A	N/A
2003 and YTD 2004**	N/A	N/A	27%	55%	73%	45%	N/A	N/A

* Information compared to 1990 census data.

** Information compared to 2000 census data.

Responses to Complaints

FNB and the OCC have not received any complaints about its performance in helping to meet AA credit needs during this evaluation period.

Fair Lending or Other Illegal Credit Practices Review

An analysis of public comments and consumer complaint information was performed according to the OCC's risk based fair lending approach. During our evaluation, we found no evidence of illegal discrimination or other illegal credit practices.